

# From headline statistics to lived experiences: a new approach to measuring the poverty premium

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## Abstract

The poverty premium, when households pay more for essential goods and services because they are poor, remains a problem in the UK today. Previous attempts to measure it, however, have been crude. This research aimed to take the measurement of the poverty premium beyond an illustrative figure to something which better reflects the lived experiences of poorer households. To achieve this, we developed a conceptual framework to understand how the poverty premium arises, taking a process-driven rather than a traditional sector-based approach to identify components of the poverty premium. We then calculated a typical cost for each component and surveyed lower-income households to measure exposure to them. The average poverty premium incurred was £490. Finally, cluster analysis explored the underlying heterogeneity of the poverty premium. Importantly, our approach reveals the breadth and depth of people's experience of the poverty premium and the pathways which contribute to it. It has highlighted the implications of behaviour and constraint for effective practice and policy intervention, and will make it possible to monitor the poverty premium more accurately and meaningfully over time.

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## Introduction

Given that poverty describes, rather simply, a lack of resources (Townsend, 1979), the notion that poorer households should then pay more to access essential goods and services than better-off households is counter-intuitive. However, the term 'poverty premium' was first coined in 1960s USA (Caplovitz, 1963) to reflect the recognition that poor households were indeed paying more for their essential goods and services **because** they were poor. Sadly, the poverty premium remains a real and important issue in the UK today, and represents structural disadvantage for those least able to afford it (for example Strelitz and Lister, 2008; Bevan, 2009; Stewart, 2010; Hirsch, 2013; Richards, 2015).

A resurgence in interest began in 2007 with work by Save the Children and Family Welfare, which estimated the poverty premium to be just over £1,000. By 2010, the poverty premium had risen to an estimated £1,300 per family per year (Save the Children, 2010). These estimates were important in raising the profile of the problem, stimulating discussion and informing the social policies needed to resolve it (for example Joseph Rowntree Foundation, 2016).

However, there were significant limitations to the estimates from these studies. They were essentially illustrative figures, and for the low-income households they were intended to relate to, they remained hypothetical. In particular, the calculation of the premium was predicated on the assumption that a low-income household incurred all of the individual elements of the premium, from a home contents insurance premium costing £32 to buying a cooker costing an extra £430 (Save the Children, 2010). Yet, in reality, any given household may or may not incur a particular premium. Qualitative research has shown not only how profound the impact of the poverty premium can be on households, but also that exposure to it can vary widely (Cambium Advocacy, 2015). Without knowing the breadth and depth of the lived experience of the poverty premium, these headline figures risked overstating the scale of the poverty premium, and potentially directing disproportionate amounts of policy attention to costly but relatively uncommon poverty premiums. In addition, poverty itself was not always established clearly as a key contributory factor in the extra costs arising and this could also risk overstating the reality of the poverty premium. As such, the estimates were limited in the extent to which they reflected the reality of households' experiences.

Our research (Davies et al, 2016a) undertook to measure, comprehensively, the poverty premium as it exists in Britain today. Our aim was to seek a new approach to measuring lower-income households' exposure to the poverty premium which better reflected their lived experiences of it; something previous studies had not done. This would relate poverty as a key, contributory factor to additional costs arising (defining the premium as a poverty premium) and reflect households' actual and varied exposure to these extra costs in their daily lives.

## The measurement challenge

The study we conducted was ambitious; not just to take the measurement of the poverty premium beyond a nominal figure of what this extra cost could represent to poorer households, but also to reconceptualise the poverty premium to better reflect its contemporary nature. This ambition permeated throughout our approach: from how we thought about the essential living costs potentially affected by a poverty premium; through how we measured exposure to the poverty premium among lower-income households; to how we explored the different exposure of different groups of lower-income households.

We carried out the research in 2016 in three linked stages:

- ▶ First, we undertook a conceptualisation exercise to identify the range of poverty premium components which exist today. This needed to take account of the changing poverty premium landscape and identify the pathways through which a poverty premium could be understood to arise. From this, we developed a new measurement framework, which we validated in focus groups
- ▶ Second, we completed a costing exercise to identify a representative, nominal cost for each component in the final measurement framework. At this stage, we also undertook a survey of lower-income households to measure exposure to each one. This enabled us to calculate the average, lived cost of the poverty premium given the depth (the nominal cost) of each component and its breadth (percentage of households experiencing it)
- ▶ Finally, we carried out cluster analysis of the survey data to explore the heterogeneity of the lower-income households' experiences of the poverty premium. This identified significant variations in households' experiences and highlighted important socio-demographic drivers of these

For the purposes of this study, we defined lower-income households as those with incomes equivalised for household size of below 70% of national median income by life-stage (working age or state-pension age). This ensured that we included those whose incomes were below the relative poverty threshold,<sup>1</sup> **and** those above the threshold whose low incomes still resulted in them incurring poverty premiums.

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<sup>1</sup> 60% median income equivalised for household size.

We used a mixed-methods design, which included an extensive review of empirical literature of poverty, money management and the poverty premium; a desk-based review of the sectors in which a poverty premium might arise; and a costing exercise to identify representative nominal costs for each component in the final measurement framework. We also undertook seven focus groups in England and Scotland with lower-income householders of working and state-pension age. We developed a bespoke questionnaire to capture the main components of the poverty premium in a nationally representative face-to-face omnibus survey, with a final sample of 947 lower-income householders. A stakeholder group of research, industry and charity experts convened specially for the study was consulted at all key stages of the research. For more details about the fieldwork and definitions see Davies et al (2016b).

## Stage 1: from poverty to the poverty premium: developing a new framework

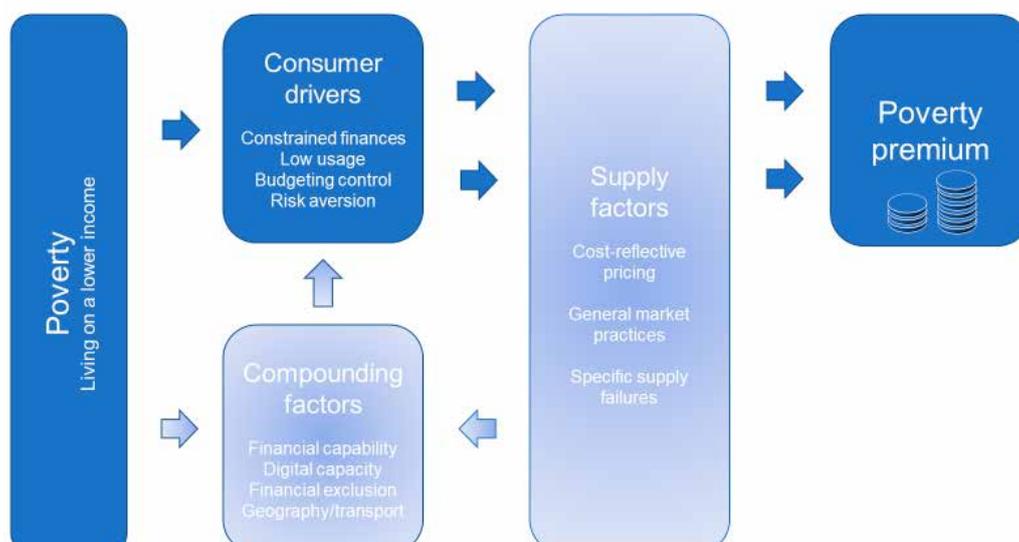
In creating a new measurement framework to account for the poverty premium as it exists today, we needed to establish, front and centre, the extra costs that can occur when people buy essential goods and services, which could constitute a poverty premium. Our overriding concern lay in establishing that any extra costs lower-income households incurred had their roots in poverty. Viewing the poverty premium through the lens of the consumer was at the heart of this.

### Developing a new conceptual underpinning

Unlike previous research, our approach involved developing a conceptual model which emphasised the behavioural pathways through which poverty leads to the poverty premium. This saw the poverty premium as arising from the circumstances, needs, choices and constraints of lower-income households, including the interaction of these with other factors. To ensure that our initial conceptualisation remained grounded in the lived experiences of lower-income households, we drew heavily on the empirical research literature of experiences of poverty and of household money management in this context. Key elements of our initial model were then refined and validated through focus groups with people in or near poverty and the stakeholder group convened specially for the project.

The final conceptual model (Figure 1) summarises the main pathways from poverty ('living on a lower-income') to the poverty premium. It emphasises the direct role of low incomes on consumption behaviour in dark shading and the indirect role of supply and other compounding factors in light shading.

Figure 1: Conceptualising pathways to the poverty premium



## Drivers, factors and their interactions

The key influences in the model come from the ‘consumer drivers’, or demand-side factors. For lower-income households these relate to how those with constrained finances behave; the difficulties in affording lump-sum and up-front costs and accessing money quickly; the lower spending power realised through low usage, including in smaller, more frequent shopping trips; and the need for insurance for smaller minimum values. The need for tight budgeting control in lower-income households can also result in smaller, more frequent shops and a preference for cash spending, prepayment meters or paper billing. Finally, limited resources can make lower-income households averse to risks such as unexpected costs, leading to more costly billing or payment method choices and a reluctance to switch providers (for example Davidson et al, 2016; Gregory, 2015; Toynbee Hall, 2014).

However, consumer drivers do not exist in isolation. Hirsch (2013) identified three main types of supply-side factors – cost-reflective pricing, general market practices and specific supply failures – which contribute to the higher prices that lower-income households pay. In effect, supply factors act as a structural filter in the marketplace, shaping the choices that lower-income households have available to them; in some cases taking those choices away (such as access to affordable credit) and in others offering new choices (such as higher-cost credit). The role of supply markets can be more profound when providers charge low users more because they are considered more expensive to serve, as is often claimed for fuel prepayment meters (for example Save the Children, 2010; McBride and Purcell, 2014).

However, supply structures also shape consumer behaviour through compounding factors. Compounding factors describe influences on behaviour that occur across the income spectrum but are more prevalent or pronounced among lower-income households. These encompass difficulties choosing products (financial capability); lower rates of internet access or digital literacy (digital capacity); no or limited access to appropriate affordable financial products (financial exclusion); and where people live (geography/transport) as barriers to getting the best prices for goods and services (for example Finney and Hayes, 2015; Helsper, 2008; Tinson et al, 2014).

Crucially, the interaction of factors emerged as important, and this was clearly demonstrated in the ongoing ‘marketisation’ of essential services. The assumption that a competitive market confers power on consumers to switch to better deals in fact disproportionately disadvantages those lower-income households which may stand to benefit financially but are not only risk averse, and may also lack the financial capability or digital inclusion to make those switching choices. Thus, while a ‘loyalty penalty’ (Citizens Advice, 2018) may not obviously arise from poverty, the factors that affect those in poverty or affect them more acutely – an aversion to direct debit, a bad credit score, or imposed supply methods – together, make it harder for them to get a good deal.

## The importance of pathways

Conceptualising the pathway for each potential component individually, from poverty to poverty premium, conferred two key advantages. First, those components for which a contributory pathway of poverty could be evidenced were supported for inclusion in our measurement framework, while those for which poverty was not clearly evidenced (such as school uniforms) could be excluded. The analysis of compounding factors, in particular, enabled us to exclude costs which arose purely due to other factors, such as age or living in a rural area.

Second, it enabled us to identify overlaps between components and to reconcile potential double-counting. For example, the reasons why lower-income households might shop in convenience stores included low usage, budgeting control and lack of private transport. Counting transport costs as a poverty premium in this context as well as a shopping premium would be to double count. Accounting for the use of higher-cost credit allowed us to capture the premiums some people on lower incomes pay when they cover the bulky expense of Christmas or white goods, again without double-counting these.

### Validating a new measurement framework

Our conceptual model produced a list of poverty premium components for further empirical investigation. A desk-analysis of the markets quickly identified that some potential components were outdated and no longer carried a premium in 2016. For example, water bills were excluded because there was no clear evidence that low-income households incurred greater costs. In other markets, such as pay-as-you-go mobiles, prices had become much more competitive in recent years.

The focus groups in turn highlighted important misconceptions about the sectors and situations in which a poverty premium might arise. For example, we found that while lower-income households were highly unlikely to switch their fuel suppliers they nonetheless felt able to negotiate good deals on their internet and TV packages: leaving a poverty premium component in one sector but not the other. We also needed to be pragmatic, which ruled out very complex potential poverty premiums, such as regressive taxation, savings interest rates and transportation costs (though noting that the last is partly addressed through the shopping premium). While this meant potentially understating the size of the poverty premium, albeit in known ways, understating the poverty premium was more tenable than overstating it, in our view, for the credibility of the findings.

As a result of this empirical approach, we identified 31 individual components (detailed in appendix A) of the poverty premium for measurement in our framework, which we have classified here into four categories of: non-standard payment methods; non-standard bill methods; products and services; and accessing money (Figure 2). Significantly, our categorisation is cross-sectoral: for example, multiple sectors (fuel and telecoms) penalise lower-income consumers for preferring paper billing; and insurance also appears as a poverty premium in more than one sector. Our conceptualisation ultimately led us from a traditional sector-driven approach (which considers sectors in silos) to a process-driven approach which addresses **why** the poverty premium exists.

**Figure 2: Final framework for measuring the poverty premium**

Non-standard payment methods	Access to products and services
Fuel prepayment meters: electricity; gas	Not switching fuel supplier in the last two years
Payment on receipt of bill: electricity; gas	Shopping in convenience stores
Monthly insurance payments: home contents; car	Deprived area insurance: home contents; car
Using prepaid cards	Specific item insurance: appliances; mobile phone
Non-standard billing methods	Accessing money
Paper billing: electricity; gas; landline/broadband; mobile phone	Fee-charging cash machines
	Fee-charging cheque-cashing
	Using higher-cost credit

## Stage 2: From hypothetical costs to lived costs

The final framework enabled us to calculate representative costs of each poverty premium component if they were incurred by lower-income households: the nominal costs of the poverty premium. It also enabled us to design questions to measure exposure to the poverty premium in the lived experiences of lower-income households.

### The nominal costs of the poverty premium

Nominal costs allocated to each component needed to be single, but typical, extra costs that a lower-income household would have to pay to access goods and services as a result of their lower incomes. This involved an extensive desk exercise, calculating costs for a range of comparable products from a range of providers.

While the calculations were often complex (see Davies et al, 2016c) they were nonetheless underpinned by some general principles. The premium was calculated by comparing the cost incurred by mainstream or non-poor customers (a low-cost benchmark) with the cost incurred by customers on lower incomes. For some components, such as cash machine charges, the benchmark was zero. For others, such as household fuel, we used a typically low-cost option as the benchmark, but not the lowest in case this was not widely accessible. When using price comparison websites to source prices, we used the average of the lowest options returned; when using provider websites, we took neither the lowest nor the highest; when a single provider dominated the market, we used that provider's cost. These principles ensured the conservative calculation of nominal costs (appendix A).

### Prevalence of the poverty premium and the lived costs

The resulting nominal costs illustrated the potential depth of the lived experience of the poverty premium, that is, how costly it is when it is incurred. However, these costs remained hypothetical unless low-income households actually incurred them.

Our key innovation when calculating the lived costs of the poverty premium was to estimate the prevalence of lower-income households' exposure to it. This was achieved through a nationally representative survey of lower-income households to measure households' experiences of the components in our framework.

The survey found that the poverty premium is widely experienced: nearly all lower-income households in 2016 (99%) had experienced at least one additional cost because they were poor. Nonetheless, exposure to the individual components varied considerably, from less than 1% of lower-income households incurring a premium from using a pawnbroker to 52% of households who paid more for home contents and car insurance because they lived in a deprived area (appendix A).

For each component, therefore, the survey findings provide a measure of the breadth of the poverty premium experience (percentage of households experiencing it). When applied against the depth of that experience (the nominal cost of the component) we could calculate the average, lived cost of each component. Calculating the costs of individual poverty premium components in this way enabled us to estimate the scale of the poverty premium as a realistic reflection of the lived experience of lower-income households; for the very first time. Across all components, the average total poverty premium lower-income households incurred in 2016 was £490.

Compared with the previous hypothetical cost of the poverty premium of £1,300 (Save the Children, 2010), the estimated lived cost of the poverty premium to lower-income households by this new method is much lower. However, it is still substantial. Moreover, our analysis showed how unevenly the poverty premium was experienced across lower-income households. For example, for couple families with two children it was estimated at £504 per year, or about 2.5% of average annual income. For a single-adult household it was lower at £465 per year but represented 5.5% of their annual income.

## Stage 3: from lived costs to lived experiences

Having estimated the average lived cost of the poverty premium and found it varied by family type, we used cluster analysis to explore the unevenness of households' experience of the poverty premium further given their patterns of exposure to the individual components. The advantage of this, data-driven, approach was the ability to analyse the large number of components simultaneously. It could, therefore, account more adequately for the underlying heterogeneity in households' poverty premium exposure while still summarising their experiences meaningfully.

We undertook a two-stage cluster analysis to allocate lower-income households into groups, maximising the similarity of poverty premium exposure within groups while maximising differences between them (Davies et al, 2016b). This returned seven groups, typifying seven distinct patterns in the nature of households' experiences. The average poverty premium ranged from a large group incurring £350 (across three components on average) to a small group spending an estimated extra £750 (across eight components, Figure 3). We nonetheless interpreted the groups primarily from the pattern of their exposure. Alongside an analysis of each group's typical socio-demographic and other characteristics, this highlighted some of the reasons why some households may pay more than others. For the full statistics underlying Figure 3, see Davies et al (2016a).

For example, 'very highly exposed' households (incurring a poverty premium of £750 on average) were defined by their use of fuel prepayment meters, the use of higher-cost credit, and insurance-related premiums. These were often tenants in their family years, living in multi-adult households and in work. They were significantly more likely than average to own cars (adding to their exposure to insurance-related premiums) and to make internet purchases. Together, this paints a picture of lower-income consumers who were active across a number of spending areas, possibly as a result of active lifestyles.

Contrast this with the 'involuntarily exposed', who made up 20% of all lower-income households. This group also incurred a high average poverty premium (£530), in this case across five components, with fuel prepayment meters and higher-cost credit featuring highly. However, members of this group were much more clearly drawn from lower occupations and had the lowest incomes of all the groups. They were also less likely than others to have switched their fuel supplier; less likely than most groups to have made recent internet purchases; and the least likely of all the groups to have a car or home contents insurance. With their exposure to the poverty premium high relative to their means, this group was apparently financially constrained. Therefore, while households in severe poverty pay a lower poverty premium, it is because they cannot afford some of the goods and services that incur poverty premiums or else are excluded in some other way.

Figure 3: A typology of the poverty premium experience

Poverty premium experience	Average exposure	Wider characteristics	Share of lower-income households
<p>'Very highly exposed'</p> <p>Defined by prepay meters, insurance, fee-charging cash machines and higher-cost credit</p>	<p>£750</p> <p>8 components</p>	Typically in work, tenants, car-owning and digitally-engaged	7%
<p>'Highly exposed'</p> <p>Defined by deprived area insurance, reliance on convenience stores, fee-charging cash machines, higher-cost credit and paper billing</p>	<p>£560</p> <p>8 components</p>	Typically families, especially lone parents, in non-metropolitan urban areas and digitally-engaged	7%
<p>'Involuntarily exposed'</p> <p>Defined by prepay meters and higher-cost credit</p>	<p>£530</p> <p>5 components</p>	Typically social tenants, lower occupations and the lowest income	20%
<p>'Traditional money managers'</p> <p>Defined by non-standard payment methods, paper billing (fuel) and reliance on convenience stores</p>	<p>£520</p> <p>7 components</p>	Typically older, single-adult households on low-to-middle incomes, outright owners and not digitally-engaged	7%
<p>'Controlled fuel payers'</p> <p>Defined by non-standard billing methods and non-standard payment methods for fuel</p>	<p>£500</p> <p>7 components</p>	A cross-section of households	14%
<p>'Risk averse'</p> <p>Defined by insurance-related components</p>	<p>£500</p> <p>7 components</p>	Typically homeowners, in work with the highest incomes of all and digitally-engaged	19%
<p>'Premium minimisers'</p> <p>Defined by typical or low exposure across the components</p>	<p>£350</p> <p>3 components</p>	A cross-section of households	26%

## Conclusions

This study has calculated the lived costs of the poverty premium to lower-income households in a new measurement framework. In achieving this, it has conceptualised the pathways from poverty to the poverty premium, and it has done so with the needs, choices and constraints of the lower-income consumer at its heart. The use of a mixed-methods approach not only enabled the breadth and depth of the poverty premium to be measured, but also ensured that any components identified in the previous literature as falling within the poverty premium were tested and validated by people living on lower incomes, rather than being imposed or assumed by the researcher.

As a result of taking this new approach, we have produced a much more realistic estimate of the poverty premium, and highlighted important misconceptions about the sectors in which a poverty premium might arise. We have found the poverty premium to be smaller than previous research has identified. However, at £490 per household on average in 2016, and with very few lower-income households left untouched, it is still substantial.

We have also identified significant heterogeneity in lower-income households' experience of the poverty premium. While these differences are often underpinned by households' different needs, choices and preferences, the apparent protection of some poorer households from some poverty premium components is more than likely due to their inability to afford the essential goods and services that carry a poverty premium; instead, they simply go without.

Being able to estimate the scale of the poverty premium as an accurate and realistic reflection of the lived experience of lower-income households is important for the credibility of the poverty premium problem. It has already gained traction in industry and policy circles, in helping to shape priorities for future policy and practice. This includes informing the new Fair by Design Fund which aims to address the poverty premium in fuel, finance and insurance markets by investing in ventures which provide alternative services to people on low incomes (Joseph Rowntree Foundation, 2017).

Moreover, a process-driven framework allows for the continued measurement and monitoring of the poverty premium as the policy and practice landscape changes. For example, since we first estimated the poverty premium in 2016, a temporary price cap on non-fixed fuel prepayment meter deals was introduced in 2017 to better align prices between payment methods. Another cap came into effect in 2019 for all customers on standard variable and default tariffs to reduce the penalty for customers who do not switch (Ofgem, 2019).

In July 2018, we updated the nominal costs to evaluate the impact of the 2017 prepayment meter price cap. We found that this cap has had a substantial effect on the gap between the average prepayment meter tariff and the best prepayment meter tariff, reducing it from £229 to just £21. At this point in time, the average prepayment meter tariff was, in fact, cheaper than the standard variable tariff paid by direct debit. This has had a knock-on effect on the poverty premium overall, which reduced 15%. Nonetheless, a gap of £174 annually remained between the average prepayment tariff cost and cost of the best online-only, direct debit tariffs. The recalculation also highlighted a large increase in insurance poverty premiums, through both geographical risk-based pricing and monthly payments.

Ultimately, a new methodology for measuring the poverty premium has not only produced a more accurate description of the nature and extent of the contemporary poverty premium. It can also be used to monitor the poverty premium experience of households over time. In doing so, it provides an opportunity to assess how each market is evolving and the extent to which changes in policy and practice – whether business-driven or from regulation – have been effective in protecting the poor in society.

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## Appendix A: the nominal and lived costs of the poverty premium

Poverty premium component	Nominal annual cost	% of households incurring it	Average lived cost
<b>Non-standard payment methods</b>			
Fuel prepayment meter: electricity	£35	32	£11
Fuel prepayment meter: gas	£35	27	£9
Payment on receipt of bill: electricity	£38	7	£3
Payment on receipt of bill: gas	£38	7	£3
Monthly insurance payments: home contents	£9	32	£3
Monthly insurance payments: car	£81	31	£25
Fee-charging prepaid cards	£25	3	£1
<b>Non-standard billing methods</b>			
Paper billing: electricity	£5	26	£1
Paper billing: gas	£5	24	£1
Paper billing: landline/broadband	£23	28	£6
Paper billing: mobile phone	£23	13	£3
<b>Product and service choices</b>			
Not switching fuel supplier in last 2 years	£317	73	£233
Best prepayment meter tariff	£227	8	£18
Best payment on receipt tariff	£43	1	£<1
Shopping in convenience stores	£266	14	£38
Deprived area insurance: home contents	£14	52	£7
Deprived area insurance: car	£74	52	£38
Specific item insurance: household appliances	£132	13	£17
Specific item insurance: mobile phones	£60	16	£10

Poverty premium component	Nominal annual cost	% of households incurring it	Average lived cost
<b>Access to cash</b>			
Fee-charging cash machines	£25	27	£7
Fee-charging cheque-cashing	£30	4	£1
Higher-cost credit: rent-to-own	£315	2	£7
Higher-cost credit: payday loans	£120	1	£2
Higher-cost credit: home collection	£540	3	£17
Higher-cost credit: pawnbroking	£50	<1	£<1
Higher-cost credit: subprime personal loans	£520	1	£7
Higher-cost credit: subprime credit cards	£194	4	£9
Higher-cost credit: mail order catalogues	£178	6	£11
Higher-cost credit: Christmas hamper schemes	47	3	1